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STATUTES CITED.

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1921.

No. 610.

SEWARD PROSSER, MORTIMER N. BUCKNER and JOHN H. MASON, as a Committee, etc.,

Appellants,

AGAINST

READING COMPANY, *et al.*,

Appellees.

REPLY BRIEF FOR APPELLANTS.

In the main brief of these appellants it was said, in reference to the distribution of the interest of Reading Company in the Coal Company, that

> "the appellee Reading Company has undertaken to show that this distribution is either a sale or is a disposition of a capital asset, or, finally, is a partial liquidation upon a partial dissolution of the company" (pp. 47, 48).

and further that

> "the appellee Reading Company, in defense of the Plan made mandatory by the decree, has argued

> indiscriminately that it is a sale, that it is a distribution of a capital asset, and that it is a partial liquidation on partial dissolution, without taking any definite position as to which of the three it claims this distribution to be" (p. 54).

In its brief in this Court, however, the appellee Reading Company has practically abandoned all the positions it took in the District Court, and has now taken the position in this Court that the distribution of its interest in the Coal Company and its union with the Railway Company, as provided in the Plan, constitute a complete liquidation on final dissolution.

This change in positions presents a new question, and this reply brief is, therefore, submitted primarily to explain this change in positions and to discuss the new question now presented.

The Positions of Reading Company in the District Court.

The positions of Reading Company in the proceedings upon the mandate of this Court, after these appellants and certain of the appellees had petitioned for leave to intervene, are shown by its Answer to Intervening Petitions and Cross Petition (Transcript, pp. 153-202) and its Memorandum in support thereof, parts of which are printed as appendices hereto.

In undertaking to show that the disposition of its interest in the Coal Company under the Plan is a sale, Reading Company stated that

> "The coal stock is to be *sold*" (italics theirs). * * * "The sale is compulsory and will result in a loss, not a profit" (Answer—Transcript, p. 162).

and further, that the

> "consideration is less than it is hoped will prove to be the intrinsic value of the coal property. It is,

however, a substantial, not a nominal, consideration and is in the judgment of the board of directors of the Reading Company adequate for the requirements of the Reading Company" (Answer—Transcript, p. 163).

Following this is a detailed discussion of the reasons urged in justification of this disposition as a sale (Transcript, pp. 163-164), concluding with the suggestion that

> "If the intervening holders of common stock object to having certificates of interest in the coal property sold to the preferred and common stockholders ratably, the remedy of the common stockholders is to offer a higher price, with the right to the preferred stockholders to bid against them; or to ask the court to require that the certificates of interest be sold at public sale to the highest bidder, with the right to the stockholders, preferred and common, singly or in groups, and to the general public, to bid" (Transcript, p. 164).

In the Memorandum in support of the Answer this disposition is described in the heading of Point 1 in the following unmistakable language:

> "The transaction is a sale of the interest of the Reading Company in the coal property, not a dividend. The fact that the selling price is less than the book value of its investment in the coal property on the books of the Reading Company, necessitating a charge against surplus, does not alter its nature" (App. A, p. 33).

and this disposition is claimed to be in all respects similar to the disposition by the Union Pacific Railroad Company of its interest in the Southern Pacific Company (App. A, p. 36), in which, as has been shown in the main brief

of these appellants (pp. 29-34), there was an actual sale at approximately the market price.*

In undertaking to show that the disposition of its interest in the Coal Company under the Plan is a disposition of a capital asset, Reading Company stated that

> "The thing to be sold, the stock of the Coal Company, is a capital asset, and not in any sense earnings or profits of the Reading Company" (Answer—Transcript, p. 164).

Following this is a detailed discussion of the reasons urged in opposition to the contention of these appellants that, if a disposition of a capital asset is, in fact, involved, the capital stock of Reading Company should be reduced accordingly.

And following this is a detailed discussion of the reasons urged for the view that the accumulated surplus of the Reading Company and of the Railway Company have been so "ploughed back into the property" as to be unavailable for dividends and as to have become a part of its *corpus* (Transcript, pp. 171-173), thus taking on, as these appellants understand the argument, the nature and characteristics of capital assets.

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*The Plan *itself* (Paragraph 5, Transcript, pp. 275-6) specifically refers to the Union Pacific-Southern Pacific case as the precedent in acordance with which the so-called sale is to be carried out and the Petition of Adrian Iselin, *et al.* (Transcript, pp. 137-138) maintains that the so-called sale is in conformity with that precedent. Accordingly, these appellants showed in their main brief (pp. 29-34) that the alleged similarity between the disposition by the Union Pacific Railroad Company of its interest in the Southern Pacific Company and the so-called sale provided in the Plan will not bear analysis. How completely the Union Pacific-Southern Pacific case has been abandoned as a precedent is shown by the fact that there is no mention of it in the brief on appeal of Adrian Iselin, *et al.*, and that the brief on appeal of Reading Company undertakes to show that it was relied upon by Reading Company only in support of its affirmative answer to a "question (not in issue on these appeals) submitted by the District Court among other questions for argument" and "that case has no bearing one way or another upon the question at issue upon these appeals, for the Southern Pacific stock was sold at or about its market value" (p. 39), thus conceding the essential distinction that these appellants insisted upon.

In undertaking to show that the disposition of its interest in the Coal Company under the Plan is a partial liquidation upon a partial dissolution of the Company, the Answer of Reading Company goes into an elaborate analysis of the terms of the charter and stock certificates, which analysis refers to such interest as one that is not being detached from the capital "by any voluntary act of the Company but only by a compulsion that makes such detachment a distribution of assets in partial liquidation of the corporation" (Transcript, p. 174).

From this analysis the conclusion is drawn

> "that, in the event—deemed so unlikely—of some uncurrent distribution not in the nature of a dividend, not declared as a dividend and compulsorily made in spite of a determination not to declare a dividend, the assets so parted with, being assets which, in the case of a liquidation or dissolution of the company, would by plain and explicit provision go to the stockholders, preferred and common, share and share alike, should go precisely the same way in case of a partial liquidation even though no dissolution occurred" (Transcript, p. 180).

And finally it is asserted that the Plan

> "is designed and intended to carry into effect the mandate of the Supreme Court of the United States requiring at least a partial liquidation of the assets of the Reading Company to the extent that it requires it to dispose of its interest in the stock of the Coal Company" (Transcript, p. 180).

The Answer having characterized the disposition of the interest of Reading Company in the Coal Company under the Plan as a partial liquidation even though no dissolution occurs, and having maintained that the rules of law governing complete liquidation on final dissolution should apply, the Memorandum, therefore, cites an English and a New Jersey case—and no Pennsylvania

cases—upon the respective rights of preferred and common stockholders upon complete liquidation on final dissolution (Appendix B, pp. 38-40).

The Opinion of the District Court.

The opinion of the District Court (Transcript, pp. 278-286) is entirely in harmony with the positions taken by the Reading Company in the proceedings before it. The opinion explains that the Coal Company stock

> "is to be taken by the Court and disposed of absolutely by it, by *sale* through the agency of a corporation created under the provisions of this decree, to such persons as have qualified to lawfully acquire it" (Transcript, p. 281—italics ours).

The opinion then declares the disposition of the interest of Reading Company under the plan to be

> "a taking by the law of an asset of that company, a *stock asset,* which was and has been owned in specie by Reading Company since the Reading reorganization was formed, and which never was earned or could be earned by the Reading Company itself" (Transcript, p. 281—italics ours).

The opinion goes on to point out that

> "Indeed it is now disposed of in substantially the same way *as the law would dispose of the property of that Company were it being dissolved* * * *" (Transcript, p. 281—italics ours).

And, finally, the opinion approves the Plan for reasons which it summarizes in the following language:

> "Seeing then that this stock is not an earning of the Reading Company to be distributed as a dividend, but is a part of its capital disposed of in this case to qualifying shareholders, in the manner provided for by the creation of this intermediate corporation, it will be apparent that this decree of equal

right to all shareholders, preferred and common alike, to participate in the sale as ultimate purchasers, is based on the general equitable principle that equality is equity and on the corporate right of all shareholders in a Pennsylvania corporation to share equally on a disposition of its assets. We are therefore of opinion that the plan which embodies these equitable principles should be approved and that the claim of the common shareholders to take all of this stock to the exclusion of the preferred stockholders should be denied" (Transcript, p. 282).

The Position of Reading Company in This Court.

In its brief on appeal Reading Company practically abandons its position that the disposition of its interest in the Coal Company under the Plan is a sale.

It is true that in one part of its brief (pp. 50-51) there is a formal summary of certain of the statements in its Answer, but no effort is made to assert, as was asserted in the Answer, that the consideration is "a substantial, not a nominal, consideration" (Transcript, p. 163). In fact, the brief asserts that

> "So great a property as that of the Coal Company cannot, under the peculiar general conditions now existing, and under the peculiar special conditions affecting the Reading coal property, be advantageously sold at this time or in bulk" (p. 50).

The sale theory is now passed over with the explanation that the

> "price which the Reading Company will receive for the coal property" was "fixed with regard to the requirements of the Reading Company" (p. 50).

Viewed from the standpoint of a sale, the Plan is stated to be

> "not only advantageous from the point of view of prompt compliance with the Mandate of this Court, in that it immediately divests the Reading Company of all ownership and control of the Coal Company,

> but is also advantageous to the stockholders of the Reading Company, in that it gives them the benefit of the hope that they may realize more for the property than the Reading Company itself could realize for it in the event of a direct sale" (pp. 50-51).

But the abandonment of the sale theory goes beyond that. The objections of these appellants to the sale theory are conceded in the following language:

> "Probably the actual value of the certificates of interest in the stock of the new corporation lies somewhere between $42,357,017.99, the book value to the Reading Company of the interest in the Coal Company sold by it to the new corporation, and $5,600,000, the purchase price to be paid by subscribers to the new corporation for certificates of interest. That the right to subscribe for the certificates of interest is a valuable right is not denied; just how valuable it is, is undetermined" (p. 10).

These objections, however, are dismissed in the following language:

> "The question of actual value is not, however, of importance on these appeals, for concededly the right to subscribe for the certificates of interest is a valuable right and the legal principles governing the disposition of that right must be the same whether its actual value be greater or less" (p. 11).

This can only mean that the Reading Company now considers it immaterial whether the disposition of its interest in the Coal Company under the Plan is a sale or not.

The Reading Company also practically abandons its position that the disposition of its interest in the Coal Company under the Plan is the disposition of a capital asset. All that its brief on appeal contains in support of this position is the following:

> "The stock of the Coal Company is a capital asset, and not in any sense earnings or profits of the Read-

> ing Company. It was acquired by the Reading Company in 1896, as part of the consideration for the issue of the present outstanding stocks and bonds (Record, p. 160), and the present book value to the Reading Company of its investment in the coal property is not materially greater than it was at the time of such acquisition (Record, p. 162)" (p. 51).

The substance of this is taken from the opinion of the District Court (Transcript, p. 281), but no argument is offered in support of it.

The Reading Company also abandons its position that the disposition of its interest in the Coal Company under the Plan is a partial liquidation upon a partial dissolution of the Company.

The expression "partial liquidation", which appears so frequently in the Answer and Cross Petition of the Reading Company (Transcript, pp. 153-202), is nowhere to be found in its brief on appeal. In lieu of that position, the brief of Reading Company now takes the position (p. 21) that

> "the decree directs and the Plan effects the disposition of all the assets of the Reading Company, the termination of its corporate life, of its business life as a holding company and its regeneration as an operating railroad company, subject to the control of the State and Federal authorities as a common carrier."

and the last section of its brief is devoted to a support of this new position (Sec. IX, pp. 63-75).

The theory upon which Reading Company now contends that the decree directs and the Plan effects a final dissolution and complete liquidation of Reading Company may be briefly stated as follows:

The decree directs and the Plan effects a liquidation of the interest of Reading Company in the Coal Company by means of the so-called sale.

This, upon the assumption that may be implied from the Reading Company's brief, leaves as its only remaining assets to be liquidated its interest in the Railway Company. It is then argued that the union of Reading Company and the Railway Company directed by the decree and to be effected by the Plan brings about a dissolution of the Reading Company, as well as of the Railway Company, and brings into existence a new corporation. The resulting surrender by the stockholders of Reading Company of their interest therein and their acquisition, in lieu thereof, of their interest as stockholders in the new corporation are stated to constitute a liquidation of the interest of Reading Company in the Railway Company, and, therefore, to effectuate a complete liquidation of its assets.

Nothing is said, however, of what is to become of certain important assets of Reading Company that have no connection with its interest in the Coal Company or its interest in the Railway Company, such, for example, as its interest in Reading Iron Company.* Presumably, this interest is to pass to the alleged new corporation, and, in view of the fact that its ownership by the alleged new corporation will be foreign to the railroad business, to which the activities of the alleged new corporation are, it is stated, to be exclusively confined, it may be assumed that the alleged new corporation will at some early date dispose of its interest in Reading Iron Company. Upon such disposition the holders of common stock of Reading Company, in view of its attitude in this appeal, may expect to be met with a plan which

* The interest of Reading Company in Reading Iron Company is represented by $1,000,000, being all, of the capital stock thereof, which is pledged under the General Mortgage (Transcript, p. 232). This capital stock, however, is practically a muniment of title of an interest of far greater value, for it is shown in the petition of Frances T. Ingraham *et al.* (Transcript, pp. 120-130) that a crude estimate made in 1920 by one of the leading financial authorities placed a value thereon of $22,791,500 (Transcript, p. 123).

will provide for the distribution of this interest to the preferred and common stockholders, share and share alike—not, perhaps, upon the theory of a dissolution and liquidation, but upon some theory designed to show that the distribution is something other than a dividend.

The Questions Now Discussed in the Brief of Reading Company.

In view of this change in positions by the Reading Company, the questions now discussed in its brief on appeal may be stated to be:

1. Whether or not the decree directs and the Plan effects a complete liquidation of the assets, and a final corporate dissolution, of Reading Company.

2. Whether or not the preferred stockholders are entitled to any distribution out of the surplus of Reading Company.

The first question was not before the District Court, as has been shown above.

The second question was before the District Court, but was not decided by it for reasons that were stated in its opinion as follows:

> "under the facts and circumstances before us, the legal question of dividend distribution between different classes of stockholders is not here involved, and on that question we express no present opinion for the simple reason that we are not dividing profits or earnings" (Transcript, p. 282).

Both of these questions are dealt with extensively in the brief on appeal of Reading Company and are discussed in their order below.

ARGUMENT.

I.

The decree does not direct and the Plan does not effect a complete liquidation of the assets or a final corporate dissolution of Reading Company.

The Plan provides:

> "6. The Reading Company will merge the Philadelphia & Reading Railway Company under the authority contained in the present charter of the Reading Company, and will subject the Railway property to the direct lien of the General Mortgage. The name of the Reading Company, after merger, will not be changed. The Reading Company will accept the Pennsylvania Constitution of 1874, and it will proceed under the Act of 1856 to surrender those of its powers which are inappropriate for a railroad corporation of Pennsylvania. Thus the Reading Company will be in all respects subject to the regulation of State and Federal authorities as a common carrier, and the relation of the Reading Company, as a specially chartered holding company, to the Philadelphia and Reading Railway Company will be terminated" (Transcript, pp. 276, 277).

This states the practical effect of the consummation of the Plan. There is nothing in the Plan, or in the Answer to Intervening Petitions and Cross Petition of the Reading Company, or in its Memorandum in support thereof, that even suggests that the effect of the Plan is to bring about a final dissolution of Reading Company and a complete liquidation of its assets as a result thereof.

In fact, the foregoing quotation from the Plan negatives any idea that there is to be a dissolution of Reading Com-

pany; for it states, not that it is the corporate existence of Reading Company which is to be terminated, but merely its relation as a specially chartered holding company to the Philadelphia & Reading Railway Company. Furthermore, throughout its lengthy Answer to Intervening Petitions and Cross Petition (Transcript, pp. 153-186), the Reading Company, both as it now exists, and as it would exist after its proposed union with the Railway Company, is referred to in identically the same way. An examination of this Answer and Cross Petition makes it clear beyond question that it was written without any thought that Reading Company after its proposed union with the Railway Company would be a corporation distinct from Reading Company as it now exists.

The Reading Company in its brief on appeal now contends that

> "Under the law of Pennsylvania whenever there is a union of two or more corporations, the resulting corporation is a new corporation, distinct from any of the original corporations. This is true whether the union be called a merger or a consolidation; the the two terms are interchangeable" (pp. 71, 72).

As authority for this proposition, the following cases are cited:

Lauman v. *The Lebanon Valley R. R. Co.*, 30 Pa. St. 42;

Dalmas v. *Philipsburg & Susquehanna Valley R. R. Co.*, 254 Pa. St. 9; and

Pennsylvania Utilities Co. v. *Public Service Comm.*, 69 Pa. Sup. Ct. 612.

The *Lauman* case, *supra*, was examined by this Court in *Central Railroad and Banking Co.* v. *State of Georgia*,

92 U. S. 665, and in its decision this Court said, at page 671:

> "*Laumann* v. *R. R. Co.*, 30 Pa. 46, was a bill by a stockholder for an injunction against consolidation; and all that was decided was, that his interest must be protected before consolidation could take place."

In the *Dalmas* case the Supreme Court of Pennsylvania affirmed a decree on the opinion of the Court below and wrote no opinion of its own. The opinion of the Court below dealt with acts of the Legislature of the State of Pennsylvania other than the Act of 1909 (Laws of Pennsylvania, 1909, p. 408, No. 229), pursuant to which the proposed union of Reading Company and the Railway Company is to take place, and cannot, therefore, be considered authority for the general proposition above quoted, or authority for anything beyond the meaning of the acts it discusses as applied to the facts in the case.

The *Pennsylvania Utilities Co.* case, *supra*, deals with nothing but the effect upon the status of corporations which unite under it of the Act of 1909, *supra*, pursuant to which the proposed union of the Reading Company and the Railway Company is to take place. The decision is confined strictly to the meaning of that act, and cannot be deemed authority for any such general proposition as the one above quoted. This case is further discussed in its proper relation.

In its brief on appeal, however, Reading Company relies on the following language from the opinion of the lower Court upon which the Supreme Court of Pennsylvania in the *Dalmas* case, *supra*, affirmed the decree:

> "When two or more corporations merge, the presumption is that all of the property of each constituent company is transferred to and becomes the property of the new company, and that from the time of the completion of said merger the constituent companies cease to exist so far as the terms of the act

> of assembly, under which said merger is effected, preserve their existence; and in order to overcome this presumption there must be a saving clause in the merger proceedings. No such saving clause appears in this bill" (pp. 72, 73),

and points out that there is no such saving clause in the charter of the Reading Company (p. 73).

Following this, it quotes Section 1 of the Act of 1909, *supra*, pursuant to which the proposed union of Reading Company and the Railway Company is to take place, and, as construing the meaning of said section, quotes from an opinion of one of the Superior Courts of Pennsylvania, in the *Pennsylvania Utilities Company* case, *supra*, as follows:

> "It is clear the ultimate effect of this act is to provide a method of incorporation, and, as individuals are associated to form a corporate entity, so two or more corporations may be associated to form a single corporate entity. Upon consolidation thereunder the constituent companies are deemed dissolved and their powers and faculties to the extent authorized are vested in the merged company as a new corporation. It is an entity entirely distinct from that of its constituents. It draws its life from the act of consolidation. The fact that to ascertain the powers and faculties of the new company you must be referred to what existed in the old companies does not affect this result: * * *" (pp. 73, 74).

It seems that the meaning of this section has never been passed upon by the Supreme Court of Pennsylvania. This section authorizes a corporation

> "to merge its corporate rights, franchises, powers, and privileges with *and into* those of any other corporation or corporations transacting the same or a similar line of business, so that by virtue of this act such corporations may consolidate, and so that all the property, rights, franchises, and privileges then

> by law vested in either of such corporations, so merged, shall be transferred to and vested in the corporation *into which* such merger shall be made:" (Reading Company Brief, p. 73—italics ours).

The powers granted in this section extend primarily to the corporations that are to be merged *into* other corporations, and not to the corporations *into which* the merger is to be made. As to the latter, this section clearly indicates that their corporate existence is to continue. The statement in the opinion of the Superior Court that "Upon consolidation thereunder the constituent companies are deemed dissolved and their powers and faculties to the extent authorized are vested in the merged company as a new corporation" is clearly contrary to the plain meaning of said Section 1 taken alone.

This act contains no grant of corporate powers but merely continues the corporate powers of the constituent corporations. Section 1 is the essential part of the act, but the following sections, which deal with the mechanics of the union of the corporations, employ the term "new corporation" in a descriptive sense. This would not seem to satisfy the following rule as laid down by this Court.

In *Central Railroad and Banking Company* v. *State of Georgia, supra,* this Court said, at page 670:

> "It may be that the consolidation of two Corporations, or amalgamations, as it is called in England, if full and complete, may work a dissolution of them both and its effect may be the creation of a new Corporation. Whether such be the effect or not must depend upon the statute under which the consolidation takes place, and on the intention therein manifested. If, in the statute, there be no words of grant of corporate powers, it is difficult to see how a new Corporation is created. If it is, it must be by implication; and it is an unbending rule that a grant of

corporate existence is never implied. In the construction of a statute, every presumption is against it."

Reading Company in its brief on appeal reaches the conclusion that

> "The Reading Company will thus be deprived, by the decision of this Court, and the execution of the Plan, of its properties, its corporate powers, its corporate existence even. Though the proceedings take the form of a merger by the Holding Company of the Railway Company, a new corporation will result from these proceedings, and that not a holding company but a railroad company" (p. 74).

It is submitted that the proposed union of Reading Company and the Railway Company not only takes "the form of a merger by the Holding Company of the Railway Company", but actually is a merger by the Holding Company of the Railway Company, and that the "very complete and practical dissolution of the Reading Company" that its brief on appeal (p. 74) refers to has no foundation in fact or substance, and has not even a technical existence except upon the authority of the opinion of one of the lower Courts of the State of Pennsylvania in the *Pennsylvania Utilities Company* case, *supra*.

It is upon this showing that this Court is asked to conclude that the decree directs and the Plan effects a final dissolution of Reading Company and a complete liquidation of its assets upon such dissolution.

Even though the claim that a dissolution of the Reading Company will arise upon the proposed union of Reading Company and the Railway Company may be supported by some language in the act pursuant to which the union is to take place indicating the intent of the Legislature that a new corporation should come into existence, such dissolution would not be, in substance, a dissolution at all, but a mere legal fiction.

This is a suit in equity, and this Court will look through the forms to the realities of the situation. Furthermore, this Court would not make its determination upon the basis of an abstract legal fiction in a case such as this even if such a fiction in support of Reading Company's claim of dissolution were in existence, where upon the basis of the concrete realities of the situation a contrary determination would be reached.

The realities of the situation are:

1. Reading Company will continue as a going concern, without any dissolution or termination of its corporate existence;

2. In doing this, Reading Company will surrender only such of its powers as it may not retain pursuant to the mandate of this Court, and pursuant to its acceptance of the provisions of the Pennsylvania Constitution of 1874, but will retain unchanged all of its other corporate powers;

3. In doing this, Reading Company will surrender only its interest in the Coal Company, but will retain unchanged all of its other assets; there will be no distribution of the assets to its stockholders as in case of liquidation on dissolution;

4. The Reading Company's corporate name will remain unchanged;

5. No change whatever in the contract between Reading Company and its stockholders and among its stockholders is to be made; and, in fact,

6. The stockholders of Reading Company are to retain, without change therein, the very stock certificates that they now hold.

If the stock of Reading Company were owned by one group of stockholders, and the stock of the Railway Company were owned by another and distinct group of stockholders, there might, of course, be some substance to the claim of a complete liquidation on final dissolution, and there might be some reality to what could be, as has been explained, under present circumstances, only an abstract legal fiction. But, in view of the realities that have just been set forth, it is submitted that this Court will not be influenced by the abstract deductions which, in contemplation of law, may be made from the union of the Reading Company and another corporation, to wit, the Railway Company, which has no stockholder except the Reading Company, and all of whose stock Reading Company has owned since the year 1896.

II.

The preferred stockholders of Reading Company are not entitled to any distribution out of the surplus of Reading Company.

The position of these appellants, as set forth in their main brief, may be summarized as follows:

1. That the distribution of the interest of Reading Company in the Coal Company under the Plan effectuates a distribution, in part at least, of or from the surplus net profits of Reading Company;

2. That the holders of the preferred stock of Reading Company are entitled to non-cumulative dividends not exceeding four per cent. per annum, and no more; and

3. That the holders of common stock of Reading Company are absolutely entitled to distributions out

to which the preferred stocks are entitled and that is expressed in the words "not exceeding four per cent. per annum" contained in the preferred stock certificates, and to show that this limitation does not apply to distributions of accumulated net earnings, to distributions of such part of the surplus as may have become a part of "capital assets" of the corporation, and, particularly, to the distribution of the interest of Reading Company in the Coal Company under the Plan, which involves a reduction in the surplus of approximately $38,000,000.

Nowhere in the brief on appeal of Reading Company is the above quoted limitation directly discussed, even in instances where it may not, on any theory, be properly ignored. Some of these instances are as follows:

On page 82 of the brief of these appellants the cases of

Fidelity Trust Co. v. *Lehigh Valley R. Co.*, 215 Pa. 610; 64 Atl. Rep. 829 (1906);

Sternbergh v. *Brock*, 225 Pa. 279; 74 Atl. Rep. 166 (1909);

Sterling v. *H. F. Watson Co.*, 241 Pa. 105; 88 Atl. Rep. 297;

Englander v. *Osborne*, 261 Pa. 366; 104 Atl. Rep. 614 (1918),

are referred to, and it is stated:

> "In each of these cases the preferred stock was *cumulative* and contained no limitation to a specified dividend in each and every fiscal year, such as is contained in the Reading Company preferred stock certificates. Consequently, the controversy between the preferred and common stockholders called for the application by the Court of the rule that is peculiar to Pennsylvania and that has been heretofore discussed."

This rule is, in substance, that a preference specified in a preferred stock certificate does not, of itself, involve a limitation, or, in other words, that no limitation can be

implied from the preference. Consequently, the above quoted part of the brief of these appellants is intended to show that the foregoing cases have no bearing upon the issues in this appeal, for the reason that the Reading Company preferred stock certificates contain a specific limitation, and that these appellants have in no instance undertaken to read a limitation into them by implication. Under these circumstances, the existence of the limitation upon the Reading Company preferred stock is of much more importance than the fact that the preferred stocks in the foregoing cases were cumulative. Nevertheless, the brief on appeal of Reading Company (p. 30) merely states:

> "The facts relied upon in the brief for the Prosser Committee (p. 82), that the preferred stocks considered in most of these Pennsylvania cases were cumulative, adds rather than detracts from their force as precedents in the Reading case"

and then continues with a discussion of the cumulative feature thereof. The limitation, which is the important consideration, is absolutely ignored.

The heading of Section II of the brief on behalf of Reading Company (p. 22) reads as follows:

> "Under the law of Pennsylvania preferred and common stockholders have equal rights except as expressly limited by the terms of the contract between them. No preference or limitation can be implied."

In support of this proposition the brief states:

> "The Pennsylvania cases establish beyond dispute the principle that, except as otherwise expressly provided in the charter or stock certificates, preferred and common stockholders have in all respects equal rights and privileges, and that no limitation on these rights is to be implied because of any preference granted" (p. 22).

and then cites the four cases above referred to. Thus, again, the specific limitation in the Reading Company stock certificates is absolutely ignored, and it is made to appear that these appellants are undertaking to read a limitation into those stock certificates by implication.

These appellants point out that the limitation upon the right to dividends to the holders of the preferred stock of Reading Company that they have urged, and have discussed, is the limitation that is contained in the preferred stock certificates themselves in the most explicit language, and they flatly deny that they have ever attempted to read into the preferred stock certificates, by implication or otherwise, any limitation other than the specific limitation that the certificates contain.

The reason why these appellants insist that the foregoing Pennsylvania cases have no bearing upon the issues in this appeal may be explained by the following quotation from the opinion in one of those very cases. In the quotation from the decision in *Fidelity Trust Co.* v. *Lehigh Valley R. Co., supra,* which appears in the brief on appeal of Reading Company (pp. 24, 25) is the following:

> "If the preferred stockholders had been limited, under the terms of the contract, to 10 per cent. per annum in any one year, and all the balance of the fund had belonged exclusively to the common stockholders, then the contention that these extra dividends should be set off as against the arrears would be sound" (p. 25).

It is submitted, therefore, that, if the preferred stockholders in that case had been limited as the preferred stockholders of Reading Company are limited—that is to say, if the preferred stock certificates in that case had provided that the preferred stocks are "entitled to noncumulative dividends at the rate of, but not exceeding, 4% per annum, in each and every fiscal year," the decision in that case, as plainly indicated by the foregoing

quotation, would have been contrary to what it was. The same is true of the decisions in the other three cases, although the opinions do not so clearly point it out.

The issue that has arisen in respect of the meaning of the terms of the preferred stock certificates does not grow out of any attempt of these appellants to imply any limitation that the preferred stock certificates do not contain, but grows out of an attempt of Reading Company, and the other appellees who are supporting the Plan, to cut down a limitation that the preferred stock certificates do contain, and the real contention of those appellees is succinctly set forth in the following quotation from the brief on appeal of the Reading Company (p. 38):

> "The Reading preferred stock certificate, on the other hand, contains no preference or limitation, expressly or by implication, *except as to participation in current dividends*" (italics ours)

and the same contention is reiterated, in varying language, throughout the greater part of the brief on appeal of Reading Company.

The attempts to support this contention proceed along two lines: first, by way of placing upon the terms of the preferred stock certificates meanings other than the meaning placed thereon by these appellants; and, second, by way of undertaking to distinguish the authorities cited by these appellants in support of the meaning placed on the preferred stock certificates by them.

Proceeding along the line first indicated, the Reading Company opens the argument in its brief on appeal by a general classification of preferred stocks. The brief concedes that the classification has been made "for the purposes of the present discussion" (p. 13), and that the classification sets forth "the general categories into which preferred stocks may properly be classified for purposes

of this discussion" (p. 15). The concession is also made that

> "No attempt is made here to describe every possible permutation and combination of the * * * principal factors"

that are set forth in the classification (p. 15).

Obviously, this classification has been prepared on the basis of the terms of the Reading preferred stock certificates, the terms of the preferred stock certificates involved in the authorities cited by the appellants, and the terms of the preferred stock certificates involved in the authorities cited by Reading Company. This classification is, therefore, special, and not general, and, consequently, is not helpful in the discussion of the issues involved in this appeal. In considering it, there will doubtless occur to this Court numerous permutations and combinations of the principal factors it contains that would destroy all of the arguments that have been based upon it; and it is evident that from a selected lot of preferred stock certificates a classification may be worked out to serve the purposes of any one of a number of arguments.

There are also some conclusions set forth in this classification that will not bear analysis. The first of these conclusions is set forth under "Non-Participating Preferred Stocks", and is that "they should not be entitled to share with the holders of common stock in a stock dividend nor to subscribe ratably with the holders of common stock for any new issue of stock since their interest is not affected by an increase in the common stock" (pp. 13, 14).

In the case of *Russell* v. *American Gas and Electric Co.* (N. Y.), 152 App. Div. 136, a holder of preferred stock, upon an increase of the common stock by means of a distribution of a stock dividend, was denied the right to participate in the common stock dividend, but was

allowed to subscribe for sufficient *preferred stock* to maintain his proportionate interest in the company. Furthermore, his preferred stock was preferred as to assets. This is fully set forth in the main brief of these appellants (pp. 71-73). Preferred stockholders are manifestly affected by an increase in the common stock of a company, and, in the absence of special provisions in the preferred stock certificates, are entitled to maintain their proportionate interest in the company upon general principles of law to which we know no exception.

The second of these conclusions is set forth under the heading of "Participating Preferred Stocks" that are participating as to dividends, and is that

> "The holders are entitled to receive a stipulated dividend before any payment is made on the common stock, and after the common stock has received a like dividend, are entitled to participate ratably in any distribution of the remaining surplus earnings" (p. 14).

This conclusion is correct only with respect to the terms of the preferred stock certificates containing no limitation when construed under the rule that is peculiar to the State of Pennsylvania and that is contrary to the weight of authority.

The fact is that preferred stocks are not subject to any classification, however rough or general, for the reason that their terms are so frequently designed to meet the peculiar organization, or reorganization, or financial, problems from which they arise, and the variety of these problems is as extensive as the variety of corporate and financial problems that arise from time to time in the business world.

Departing from this special classification of preferred stocks and coming to the actual terms of the preferred stock certificates the brief on appeal of Reading Company undertakes to show that between what are therein variously characterized as "current dividends" (pp. 15,

16, 20, 22, 38, 48, 55), "dividends from current earnings" (p. 56), "customary dividends" (pp. 19, 21, 22) and "customary distributions from current earnings" (p. 19), on the one hand, and distributions of assets upon final liquidation, on the other hand, there is a twilight zone into which falls the distribution of the interest of Reading Company in the Coal Company; and that the respective rights of preferred and common stockholders, as to distributions of assets that fall into this alleged twilight zone, are to be determined by the rules applying to final liquidations rather than by the rules applying to dividends (pp. 21, 22).

No authority for such a proposition has been cited, and it has been condemned in the authorities cited in the main brief of these appellants, and hereinafter discussed. And no characterization of the word "dividends" as it appears in the preferred stock certificates, such as has been explained above, is justified by anything these certificates contain.

The effect is, of course, to set up a twilight zone to which the limitation as to dividends that is contained in the preferred stock certificates will not apply and to which will apply the general rule that in distribution of assets on final liquidation all classes of stock share equally.

There are two considerations that negative the conclusions that are urged as a result of this effort.

In the first place, the preferred stock certificates refer in three places to dividends at the rate of 4 per cent. per annum as "full dividends", thus clearly disposing of the theory that, short of final liquidation, the preferred stocks can participate in distributions of assets at a rate in excess of 4 per cent. per annum.

In the second place, the preferred stock certificates provide that:

> "The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law."

thus clearly disposing of the theory that the preferred stocks have any absolute right to share equally with the common stock in distribution of assets on final liquidation.

This theory, however, has been practically abandoned in the brief on appeal of Reading Company, for it refers to

> "property of all the stockholders, preferred and common, share and share alike, available for equal distribution among them, under the circumstances here obtaining; subject, however, to the right of the company, *under equitable conditions,* to eliminate the preferred stockholders as sharers therein by redeeming the preferred stock at par" (p. 58, italics ours)

and thus practically concedes the claim of these appellants that this right of redemption is, in equity, a limitation upon the general rule that in distribution of assets on final liquidation all classes of stock share equally.

The brief on appeal of Reading Company also undertakes to show that

> "The decision of the board of directors"
>
> A. "as to the portion of current earnings up to 4% on the preferred stock which shall go to the preferred stock as dividends, and"
>
> B. "the portion of current earnings, after payment of dividends of 4% to the preferred stock, which shall go to the common stock"
>
> C. "is binding, and
>
> D. "the surplus net profits, of any year, which the board of directors has not determined to declare out for dividends, become part of the general assets of the Company",
>
> E. "which, in the case of an extraordinary distribution under the circumstances here obtaining are—as between preferred and common stockholders—sub-

ject to no preference but are distributable to them share and share alike, without discrimination and without priority or limitation of right" (p. 58 dissected for purposes of discussion).

So much of the foregoing as is comprehended under A, B, C and D is obviously true. All of the assets of a corporation are general assets, in the sense used above, until declared as dividends or until complete liquidation on final dissolution is reached. But E does not follow.

In no case that has been cited has the right of holders of preferred stock to participate in an extraordinary distribution been sustained, except where their shares were *cumulative* or they were entitled to receive the par amount of their shares with accrued dividends thereon upon liquidation. The *Fidelity Trust Company, Sternbergh, Sterling* and *Englander* cases, *supra,* all come within the exception. These are the Pennsylvania cases upon which the appellees who are supporting the Plan rely. But the Reading Company preferred stock is neither cumulative nor entitled to accrued dividends upon liquidation, and the aforesaid Pennsylvania cases turn on facts that have no resemblance to the facts in this appeal.

Proceeding along the line next indicated, the brief on appeal of Reading Company undertakes to distinguish the authorities cited by these appellants in support of the meaning placed on the preferred stock certificates by them.

In *The Equitable Life Assurance Society* v. *Union Pacific R. R. Co.,* 212 N. Y. 360, the preferred stock was not preferred as to assets and the words "such Preferred Stock is entitled to no other or further share of the profits" beyond non-cumulative dividends not exceeding 4% per annum were not the determining factor in that case as stated in the brief on appeal of Reading Company (p. 37). The absence of the words quoted would not have

changed the decision. *Stone* v. *United States Envelope Co.*, 119 Maine, 394, and cases discussed therein.

In *Scott* v. *The Baltimore and Ohio R. R. Co.*, 93 Md. 475, the same limitation upon the preferred stocks as exists in the Reading Company preferred stock certificates was solely involved. The brief of Reading Company (p. 40) undertakes to distinguish as *dictum* certain parts of the opinion that apply directly to the facts in this appeal, but that alleged *dictum* related to matters that could not have been left out of consideration in the decision in view of the manner in which the issues were presented to the court.

In *Russell* v. *American Gas and Electric Co.*, 152 App. Div. (N. Y.) 136, and *Niles* v. *Ludlow Valve Mfg. Co.*, 202 Fed. Rep. 141, the decisions did not turn on the matters referred to in the brief on appeal of Reading Company (pp. 41-43). A preference as to assets does not necessarily give a preferred stockholder any ground to complain of dividends to the common stockholders that do not impair the capital of the corporation. And, as already pointed out, the preferred stock of Reading Company is, in equity, limited as to its participation in assets by the right to redeem the same.

III.

The Plan does not involve a liquidation of the assets of Reading Company.

Under the Plan, the interest of Reading Company in the Coal Company is not to be distributed to the stockholders. The stockholders may not acquire such interest without ceasing to become stockholders. Nor is such interest to be sold and the proceeds distributed to the stockholders. Instead the Plan "makes the stockholders

of the Reading Company a conduit for the transmission of the ownership of the certificates of interests to persons not stockholders in the Reading Company" (Reading Brief, p. 50).

Likewise, under the Plan, the interest of Reading Company in the Railway Company and its other assets are not to be distributed to the stockholders nor are the same to be sold and the proceeds distributed to the stockholders. These assets are to remain undisturbed.

There is to be no such liquidation as to invoke the general rule that all stockholders, preferred and common, share and share alike, participate equally in a final distribution of assets.

Respectfully submitted,

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APPENDIX A.

MEMORANDUM IN SUPPORT OF ANSWER TO INTERVENING PETITIONS AND CROSS-PETITION OF DEFENDANT READING COMPANY.

POINT 1. The transaction is a sale of the interest of the Reading Company in the coal property, not a dividend. The fact that the selling price is less than the book value of its investment in the coal property on the books of the Reading Company, necessitating a charge against surplus, does not alter its nature.

It is the real nature of the transaction and the character of the asset disposed of, not the effect of such disposition on the books of the company, which determine the rights in respect of such disposition.

United States v. *Union Pacific Railroad Company,* 226 U. S. 61 (1912).

United States Trust Company of New York v. *Heye,* 181 A. D. (N. Y.) 544; 224 N. Y. 242 (1918).

It seems advisable to set out in some detail the facts in connection with the dissolution of the combination between the Union Pacific Railroad Company and the Southern Pacific Company and the dissolution of the Standard Oil Trust, in connection with which these cases arose.

A. The Union Pacific Case.

(*a*) The Union Pacific Railroad Company is a corporation of the State of Utah, having both preferred and common stock. Prior to 1908, the Union Pacific owned all the stock of the Oregon Short Line Railroad Company, which in turn owned $126,650,000, par amount, of the stock of the Southern Pacific Company or about 46% of the outstanding stock. In that year, the Government

brought suit against the Union Pacific, the Oregon Short Line and other defendants, alleging a combination in restraint of trade in violation of the Sherman Act. In 1912 the Supreme Court held that an illegal combination existed, and directed that a plan providing for the disposition of the Southern Pacific stock should be filed with the District Court for the District of Utah. *United States* v. *Union Pacific Railroad Company, supra.*

Thereafter, various plans were submitted to the District Court and on June 30, 1913, that Court entered a decree approving the sale of $38,292,400, par value, of the Southern Pacific stock to the Pennsylvania Railroad Company in exchange for $42,547,200, par value, of the stock of The Baltimore and Ohio Railroad Company, half preferred and half common, and directing that the remaining shares (883,576) should be transferred to Central Trust Company of New York, as Trustee, and that the right to subscribe to certificates of interest representing such shares should be offered to all stockholders of the Union Pacific, common and preferred, *pro rata,* at such price as the Union Pacific should determine.

Pursuant to this decree the Union Pacific offered its stockholders, preferred and common, the right to subscribe ratably to such certificates of interest at $88 a share, and accrued dividends. At the time of this distribution the Southern Pacific had a surplus of more than $60,000,000.

(*b*) Thereafter the Union Pacific declared an extraordinary dividend on its common stock consisting of the following amounts on each share: 1. three dollars in cash; 2. twelve dollars, par value, of preferred stock of the Baltimore and Ohio; 3. twenty-two and a half dollars, par value, of the common stock of the Baltimore and Ohio. The regular dividend on the common stock was at the same time reduced from 10% to 8%, the

reduction being the exact equivalent of the income value of the extraordinary dividend.

The Union Pacific stock certificates provide:

> "The holders of Preferred Stock shall be entitled, in preference and priority over the Common Stock of said Company to dividends in each and every fiscal year at such rate not exceeding 4 per cent. per annum, payable out of net profits, as shall be declared by the Board of Directors.
>
> Such dividends are non-cumulative *and such Preferred Stock is entitled to no other or further share of the profits.*"

A preferred stockholder sought to enjoin the payment of this dividend to the common stock exclusively, but it was held that this was a dividend declared out of profits, and that, as the preferred stockholders, having received 4% dividends, were entitled to no other or further share of the profits, the dividend was properly declared to the common stockholders.

> *The Equitable Life Assurance Society of the United States* v. *Union Pacific Railroad Company,* 162 A. D. (N. Y.) 81, 212 N. Y. 360 (1914).

B. The Standard Oil Dissolution.

Prior to 1911 the Standard Oil Company of New Jersey owned the stock of thirty-three subsidiary companies. In that year, on the suit of the Federal Government, a decree was entered in the United States Circuit Court enjoining the continuance of this unlawful combination and permitting the Standard Oil Company to distribute the stocks of its subisdiary companies among its own stockholders. Thereupon the directors resolved that the stocks of subsidiary companies be distributed among the stockholders of the parent company and that the book value of the stocks distributed be charged to "Reserve Profits". The

rights arising out of this distribution were considered by the New York Courts in *United States Trust Company of New York* v. *Heye, supra.*

This case involved the rights of a life tenant and remainderman under a trust created in 1899. Most of the stocks distributed had originally formed part of the trust estate, and had been exchanged for stock of the Standard Oil Company of New Jersey. The book value of the Standard Oil stock, December 31, 1899, was $202.32 per share. Before the distribution of December 1, 1911, accumulated earnings had brought the value up to $566.67, and after the distribution the book value was $281.72 per share. Therefore, the "Reserved Profits" account against which the distribution was charged consisted largely of earnings accumulated since the creation of the trust. The subsidiaries whose stock was distributed also had large accumulated earnings. The Court said that earnings accumulated since the creation of the trust went to the life tenant, but nevertheless held that the remainderman was entitled to all the stock so distributed except that which had been actually acquired by the Standard Oil Company out of earnings accumulated since the creation of the trust.

C. Application of Foregoing Cases to Point 1.

The difference between the rights of stockholders in case of a sale and their rights in case of a dividend is shown by the two cases arising out of the Union Pacific dissolution proceedings. In the Baltimore and Ohio stock distribution case, *The Equitable Life Assurance Society of the United States* v. *Union Pacific Railroad Company, supra,* the court held that the Baltimore and Ohio stock distributed (a part of which had been received in exchange for Southern Pacific stock) represented profits of the Union Pacific, and accordingly, when distributed by way of dividend, was properly given to the common stockholders exclusively. In the dissolution proceedings, how-

ever, when the transaction in question was a *sale,* the court directed that the remaining Southern Pacific stock be sold to preferred and common stockholders, *pro rata.*

In the *Heye* case (Standard Oil dissolution) the Board of Directors had resolved that the book value of the stocks distributed should be charged to "Reserve Profits", which consisted in large part of earnings accumulated since the creation of the trust. (See p. 4.) The Court stated the rule that earnings accumulated since the creation of the trust belonged to the life tenants, but nevertheless held that the remainderman was entitled to all the stocks which had originally formed part of the principal of the trust in spite of the fact that the distribution reduced the amount of surplus shown on the books and available for distribution in dividends to the life tenant.

APPENDIX B.

MEMORANDUM IN SUPPORT OF ANSWER TO INTERVENING PETITIONS AND CROSS-PETITION OF DEFENDANT READING COMPANY.

POINT 6. Preferred and common stockholders share equally in the event of dissolution or liquidation of a corporation, unless they are expressly preferred or limited by the terms of the contract between them.

It is well settled that a preference as to dividends does not imply either a preference or a limitation in respect of the right to share equally in assets on liquidation or dissolution.

> *Birch* v. *Cropper* (*In re The Bridgewater Navigation Company, Limited*) 14 A. C. 525 (House of Lords 1889);
> *Lloyd* v. *Pennsylvania Electric Vehicle Company*, 75 N. J. Eq. 263, 72 Atl. 16 (1909).

In the *Bridgewater* case the company issued stock expressly preferred as to dividends, but not as to assets. The Articles of Association contained no provision as to the distribution of assets on winding up. The Company was dissolved, and after all debts and expenses had been paid, and after repaying to the stockholders the amount of capital paid up, a balance remained. It was held that this should be divided among the shareholders, share and share alike. LORD MACNAGHTEN said at page 546:

> "The ordinary shareholders say that the preference shareholders are entitled to a return of their capital, with 5 per cent. interest up to the day of payment, and to nothing more. That is treating them as if they were debenture-holders liable to be paid off at a moment's notice. Then they say that at the utmost the preference shareholders are only

entitled to the capital value of a perpetual annuity of 5 per cent. upon the amounts paid up by them. That is treating them as if they were holders of irredeemable debentures. But they are not debenture-holders at all. For some reason or other the company invited them to come in as shareholders, and they must be treated as having all the rights of shareholders, except so far as they renounced those rights on their admission to the company. There was an express bargain made as to their rights in respect of profits arising from the business of the company. But there was no bargain—no provision of any sort—affecting their rights as shareholders in the capital of the company."

* * * * * *

"* * * I think it rather leads to confusion to speak of the assets which are the subject of this application as 'surplus assets' as if they were an accretion or addition to the capital of the company capable of being distinguished from it and open to different considerations. They are part and parcel of the property of the company—part and parcel of the joint stock or common fund—which at the date of the winding-up represented the capital of the company. It is through their shares in the capital, and through their shares alone, that members of a company limited by shares become entitled to participate in the property of the company."

In the case of *Lloyd* v. *Pennsylvania Electric Vehicle Company,* a New Jersey corporation, preferred stockholders, preferred only as to dividends, were paid on dissolution the full par value of their stock. The remaining assets were insufficient to pay the common stockholders in full. The court held that the assets should have been divided ratably among the preferred and common stockholders, since, when a corporation undertakes to set forth the preference to which preferred stock is entitled, instead of relying on the preferences given by statute, the preference must set forth fully, and so far

as no preference is expressed, the preferred stock can have no greater rights than the common stock. The Court said at page 267:

> "Nor is any difficulty presented where the terms of the contract entitle the preferred stockholder to a preference in dividends only. In this case, which, as Vice Chancellor Van Fleet said, and as the authorities show, was the ordinary case, in the absence of such a provision as that contained in section 86, the preferred stockholders and the general stockholders would share *pro rata* in the distribution of assets after the payment of dividends due the preferred stockholders. That such would be the rule is well illustrated by a thoroughly considered case in the English courts * * *". (*Birch* v. *Cropper*, *supra*).